

How to choose a broker



There are more than a thousand brokerage firms available to sell you securities. Some of these firms have Hawaii offices, but many conduct businesses from outside the state by mail, over the telephone, or by computer. No matter where they are located, Hawaii law requires all brokerage firms and their salespersons to be licensed by Hawaii Business Registration Division, of the Department of Commerce & Consumer Affairs. While licensing does not guarantee that a firm or its salesperson will perform according to your wishes, it does ensure that they have complied with the state's minimum qualification standards.

A salesperson also may be called a "broker," "sales agent," "account executive," "financial consultant," or "registered representative." Despite the differences in titles, the licensing requirements are the same.

8 steps to take in selecting a broker

1. Think through your financial objectives. Before discussing your financial goals with a broker, you need to fully evaluate your personal finances and decide how much you want to invest, how much return you need, and how much risk you are willing to take to achieve your goals.
2. Get references. Ask friends, relatives, and co-workers for the name of brokers who served them well.

3. Contact the National Association of Securities Dealers (NASD) hotline at (800) 289-9999 for more information about firms and their registered representatives.
4. Your broker must be licensed to do business in your state. Contact Hawaii Securities Compliance Branch at (808) 586-2722 for information about firms and their registered representatives. Licensing and disciplinary information also is available.
5. Conduct interviews with at least two brokers. Talk with prospective brokers about what you want, and measure their levels of responsiveness to your needs. Ask questions about their experience and education. Be wary of a broker who attempts to sell you a product regardless of its appropriateness to your circumstances. Ask for customer references by name and telephone number. Contact each reference and ask about the broker's performance and his or hers responsiveness to their needs.
6. Ask about fees and commissions. Your broker will likely receive a commission based on the size of your investment. Fully understand these costs before opening an account.
7. Determine how much service you want from your brokerage firm. A full-service firm will offer investment advice, make recommendations, and provide research support. A discount broker does not make recommendations about buying or selling a specific security.
8. Be realistic in stating your net worth and the cash you have available to invest. Do not exaggerate your net worth to impress the broker. The broker will make investment recommendations based on your investment objectives and your net worth, among other factors. He or she cannot make appropriate recommendations if you are not completely honest.

Public information available on brokers and salespersons

The NASD is the nation's largest securities self-regulatory organization with 5,500 member firms and 600,000 registered representatives. Call the NASD's toll-free hotline for important facts about the firm or individual you plan to invest with. Call (800) 289-9999 between 9:00 a.m. and 5:00 p.m., EST for the following information

Final disciplinary actions and criminal convictions involving firms, brokers, and individuals registered with the NASD;

Civil judgements involving securities matters;

Formal disciplinary proceedings that are pending before the Securities Exchange Commission (SEC), the NASD, other self-regulatory organizations, and individual states;

Criminal indictments reported by the securities industry and the U.S. Department of Justice; and

Pending or final NASD proceedings.

The Central Registration Depository (CRD)

The CRD is a data bank containing information about the employment, qualifications, and disciplinary history of the industry's 5,500 member broker/dealers firms, and 600,000 active registered representatives. When a firm or individual is sanctioned in Hawaii or by any other state or regulatory organization, that information is added to the CRD data bank.

Types of brokers

Brokerage firms may be classified into three basic types: full service, discount, and limited products.

Full-service brokerage firm

A full-service brokerage firm can provide you with a complete package of investment services, including recommending securities, researching a particular issue, or providing individualized service through a salesperson. The firm receives its payment in the form of a commission that is calculated according to the type of security and the amount you are investing. A full-service firm is generally best for those who are new to the market or who do not have the time or the desire to do their own investment research.

Discount brokerage firm

While a discount brokerage also can provide you with a wide range of services, its salespersons are not allowed to give investment advice, to make recommendations, or to provide research materials. For these reasons, a discount firm can offer substantially lower commissions than full service brokers. Experienced investors capable of doing their own investment research typically use a discount firm.

Limited products firm

These brokerage firms specialize in a limited number of securities products, such as mutual funds, limited partnerships, or specific bonds.

As an investor, you should shop for a brokerage firm just as you would for any other professional service. Brokerage firms come in all size, from "one-man-firms" to international corporations. Similarly, the services offered by each firm and the commissions they charge vary significantly.

Opening and account: The new account agreement

Rule one:

Be honest when filling out the new account form. Your account representative cannot recommend investment to you unless he or she understands your financial picture and the level of risk you are willing to accept.

Rule two:

Do not sign the form until it is completed, the information is accurate, you understand it, and you are willing to accept the terms and conditions it imposes on you. Take your time and ask questions. Read the fine print.

Rule three:

Take a copy of your new account form when you leave. It is the basis for determining what is a suitable or appropriate investment for you.

Making the right decisions

Discretionary authority

You will have to make a very important decision at this point, such as whom will make the investment decision for your account. Ordinarily, you will make your own investment decisions unless you give your broker *discretionary authority* to make the decision for you. Discretionary authority allows your broker to make investment decisions based on his or her determination of what will best meet your investment objectives. *Your broker will then do so without consulting you about the price or type of security or when to buy or sell.*

If you decide to give the broker discretionary authority for your account, you should do so in writing. If you give discretionary

authority, it is even more important that you review and understand your monthly statements, so that you know what you have purchased and how frequently investments are being made. Discretionary authority may be withdrawn at any time, and must be done in writing.

Types of accounts

If you are like most investors, you will open a *cash account*. A cash account simply refers to an arrangement requiring you pay in full for each security purchase.

Alternatively, opening a margin account will allow you to borrow money from the brokerage firm to buy securities and will require that you pay interest on that loan. If you buy securities on margin, remember that you are liable for the full outstanding balance of the loan, even if the value of the securities drops. In a fluctuating marketplace, this is a real possibility.

When you sign a margin agreement, the broker is authorized to immediately sell any security in your account, without notice to you, to cover any shortfall resulting from a decline in the value of your securities.

Your stock certificate

You usually have several choices on how your stock certificates will be handled:

1. Receive a certificate made out in your name showing the number of shares purchased. This same certificate must be endorsed and returned to the broker when you sell the stock.
2. Have the stock certificate held in your name at the brokerage firms. Although the certificate must still be endorsed before selling, this option eliminates storage concerns.
3. Have your broker hold the stock certificate in *street name*. This term refers to the brokerage firm being listed as the shareholder of record of the corporation you purchased stock

in, although you, the customer, are the actual owner. Any mailings by the corporation, such as annual reports and proxy materials, must then be forwarded to you by the broker, which may delay them. However, when you sell the stock, the transfer process is much simpler.

Levels of risk

Your new account form requires that you specify the level of risk you are willing to take to achieve your overall financial objective. If you do not understand some of the categories used, ask your broker to explain what the category means. Make sure you fully understand how much risk is involved in each category.

Remember a basic investment rule: *The higher the expected rate of return, the greater the risk.* Risk means that you could lose some or all of your investment. If you are a risk taker, be sure that your broker understands that fact, so he or she can help you select investments that are right for you.

Remember

Do not make your investment check payable to the sales representative.

Do not make an investment decision on a product or a brokerage firm based solely on a telephone solicitation or sales promotion.

Do not file or throw away your account statements or transaction confirmations without first reading them thoroughly and verifying them for accuracy.

Do not invest based on "inside information," "a stunning new development," or "a dynamic new product" without investigating for yourself.

Do not abandon your common sense. If you are promised spectacular returns, such as “your money will double in a year or less,” be skeptical and ask questions.

Do not wait if you think there is a problem with your account or brokerage firm. Call your brokerage firm, the Hawaii Office of the Commissioner of Securities, or the NASD and report the problem immediately.

For More Information

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